G20 SUMMIT

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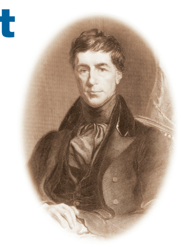

Canned heat Where Victorian aristocrats trod, modern-day politicians follow **Page 4**

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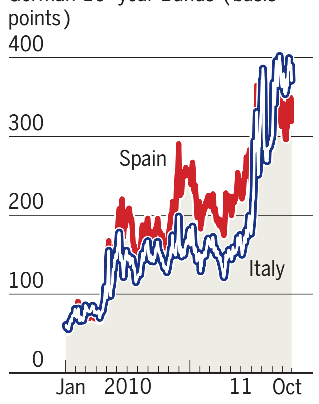
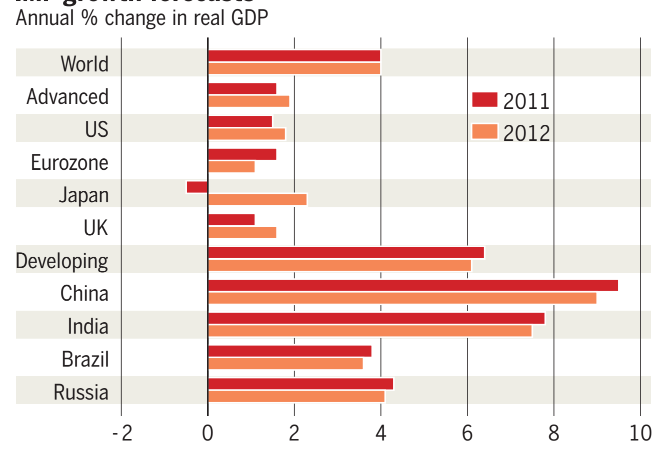
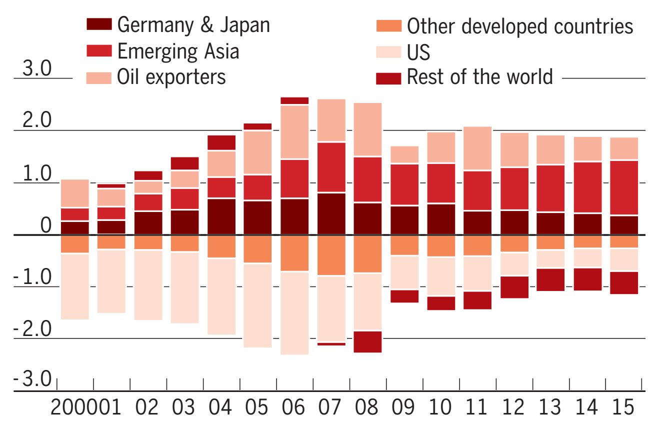
Dark outlook piles pressure on leaders

Anti-G20 placard in Nice, France this September







Sources: Thomson Reuters Datastream; IMF

Photo: AFP/Getty

A cooling world economy, the euro crisis and trade imbalances provide a grim backdrop to talks in Cannes, writes Chris Giles

It is crunch time for the Group of 20. If things go well, the Cannes summit will mark the moment the "premier global economic forum" acts to defuse the economic risks being run in the world.

The alternative is to allow them to fester, contributing towards another destructive financial and economic crisis.

Underlining the urgency, the International Monetary Fund declared in mid-October: "The immediate risk is that the global economy tips into a downward spiral of increased uncertainty and risk aversion, dysfunctional financial markets, unsustainable debt dynamics, falling demand, and rising unemployment."

Three challenges stalk the global economy.

Most pressing is the declining outlook for growth, which has become evident in the weeks following the IMF annual meetings in late September.

Then, the IMF had already downgraded its economic forecasts and warned of further risks, but most emerging economies were still growing rapidly and had experienced little fallout from the slowdown in almost all advanced economies.

Six weeks on, the world outlook seems darker, and Monday's announcement that Greece will hold a referendum on a second EU bail-out agreement has only intensified the anxiety. As the Organisation for Economic Co-operation and Development outlined earlier on Monday, "Uncertainties regarding the short-term economic outlook have risen dramatically in recent months."

The OECD significantly downgraded its 2012 growth forecast for advanced economies, cutting the eurozone forecast from 2 to only 0.3 per cent and its US forecast from 3.1 to 2 per cent.

A rapidly cooling global economy is both a consequence and a cause of the eurozone sovereign debt crisis, the second challenge.

Fixing the existential crisis of the European single currency – one that has frayed investors' nerves and knocked business and consumer confidence since the summer – is a pre-requisite for a safer global economy next year.

The crisis has many dimensions: the insolvent Greek economy; a dip in confidence in the peripheral sovereign debt of Italy and Spain that is increasing their borrowing costs substantially; and a weakness in the balance sheets of European banks that are sitting on these assets.

The issues are inextricably linked and must be addressed as a whole. This is recognised by both the French and German governments' commitment to a "comprehensive plan", the outlines of which were revealed last Thursday morning.

If the eurozone crisis were not difficult enough, deep trade imbalances are the third challenge facing the G20.

According to the IMF, current policies on trade and exchange rates suggest that enormous current account surpluses in China, Japan, Germany and relatively poor oil exporters are set to continue, forcing ever more capital to flow to finance deficits elsewhere which must balance the surpluses.

Since well before the crisis, individuals and governments in surplus countries enjoyed building claims on deficit countries, but much of this capital ended up financing increasingly risky activity at cheap rates – subprime mortgages and peripheral eurozone sovereign debt – adding to the risks that these investment flows would end in crisis and huge losses.

As Mervyn King, governor of the Bank of England, said recently: "From the very beginning of the global crisis there has been a reluctance by governments to face up to the underlying solvency problems generated by apparently unending trade deficits with no mechanism – whether flexible exchange rates or some other means – for correcting these disequilibria."

In short, the task for the G20 summit is to accelerate solutions to the latter two challenges so as to mitigate the slowing global economy and set it on a path towards the G20's long-standing ambition of "strong, stable and balanced" growth.

France, the chair of the G20 in 2011, is well aware of what needs to be done.

Speaking to the United Nations a week before the summit, Jean-David Levitte, the diplomatic adviser on the G20 to Nicolas Sarkozy, the French president, recognised the original agenda of the summit must be torn up and replaced with a co-ordinated response, because "no one is immune from the economic crisis".

He said: "France is calling on all G20 countries to adopt measures adapted to the situation and on all countries that don't belong to the G20 to support the collective efforts that will be undertaken to restore confidence."

For the G20 to play a part in any solution to the eurozone woes, non-members of the single currency area made clear at a finance ministers' meeting in Paris in mid-October the euro nations had to demonstrate they had a "decisive" plan to save the single currency.

That plan – the outlines of which were agreed at a eurozone summit a week before the G20 summit – included a comprehensive recapitalisation of European banks, a 50 per cent voluntary writedown of Greek debt, a beefed-up fund to prevent

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Inside

Meetings yet to reach the peak of achievement

History

Chris Giles finds decisiveness in short supply at the global leaders' conferences

Eswar Prasad: rifts prevent action

Living up to being "the premier global economic forum" has proved challenging for the Group of 20 ever since its members elevated the group to that role in 2009.

With the eurozone sovereign debt crisis threatening the global economic order, the group has perhaps its most difficult challenge yet at the Cannes summit.

The question is whether it will succeed or squander the chance to demonstrate its global importance.

There is no doubt the calendar this autumn has put the G20 in pole position. Since mid-September, international meetings have been scheduled almost every weekend with the deadline of arriving at a "comprehensive plan" for saving the euro by the time of Cannes.

The summit is therefore the climax of the year's negotiations. Any failure there to stamp a global seal of approval on to the eurozone outline plan agreed a week before the summit will not be followed in short order by another scheduled event.

There cannot be another postponement of difficult decisions, unless world leaders simultaneously decide to arrange emergency summits either in Europe or at a global level.

For those awaiting decisive moves from the G20 in Cannes, a look at recent history provides more cause for concern than hope. Since the financial crisis turned nasty in 2008, the G20 has achieved significantly less than its supporters and summit hosts have generally claimed.

Before 2008, the G20 was merely an annual gathering of finance ministers established after the Asian financial crisis a decade earlier, and few people expected much from its meetings. But after Lehman Brothers collapsed in September 2008, a first leaders' summit was hastily arranged for that November.

But before the G20 could meet in 2008, the Group of Seven finance ministers took all the difficult decisions, ensuring there would be no more bank failures, a guarantee of liquidity to financial markets: banks would be recapitalised and depositor protection bulletproofed. That left the G20 to focus on additional matters, such as a pledge to complete the still-unfinished Doha trade round by the end of 2008 and a halfhearted commitment to fiscal stimulus.

The April 2009 London summit is generally seen as the moment the G20 came of age, when it reversed the economic downturn with an audacious international package including what Gordon Brown, then UK prime minister, boasted was the largest fiscal stimulus "the world has ever seen" and what he called a $1,000bn "programme of support to restore credit, growth and jobs in the world economy".

The summit outcomes were, in truth, less than the claims, with nothing new announced on fiscal stimulus. The money given to the International Monetary Fund had a limited immediate effect on the crisis and there was no agreement on cleaning up the toxic assets in banks. The last issue has been something that has subsequently come to haunt the countries – particularly in the eurozone – that did not take unilateral action in that regard.

The subsequent summits have achieved little more. In September 2009, the Pittsburgh summit was notable for establishing the aim of "strong, sustainable and balanced" world growth and a process to achieve it, which has inched forward ever since.

Come the Toronto summit of June 2010, the global recovery was in full swing and sentiment had shifted to fiscal consolidation so leaders agreed to halve deficits by 2013, as they were planning to do so already.

> 'It will take some proactive engagement to restore the image of an effective body, a reputation [the G20] had after Pittsburgh'

The November 2010 Seoul summit was marked most clearly by divisions. In a rancorous meeting – with constant spats between the US and China – the G20 achieved little save for delays in the process striving for balanced growth, dressed up as progress towards the goal.

Professor Eswar Prasad of Cornell University in the US says the underlying problem is that countries put their national interests first and are willing to agree to multilateral deals only if they seem to square with their national interest.

He says: "Rifts among G20 countries tend to become exposed in calmer times, which prevents the group from taking a more concerted approach to longer-term objectives such as unified financial regulatory standards and reform of the international monetary system."

Ousmène Mandeng of UBS says the G20 missed an opportunity to remain relevant in 2011. "Failure to address critical issues and to guide market expectations when the going was rough has undoubtedly weakened its relevance and it will take some proactive engagement to restore the image of an effective body, a reputation it had after Pittsburgh at the beginning of the crisis," he says.

Since differences of outlook dominate the G20, the G8 has again had more success in making decisions in 2011. This year, France has chaired both the G8 and G20 and originally planned to take the opportunity to bury the smaller grouping.

France decided against. Instead, its finance ministry has held numerous teleconferences among G7 finance ministers (excluding Russia, which is a member of the G8); it organised co-ordinated intervention in currency markets in March to help Japan force the yen down following its earthquake and tsunami; and in August it also offered a backstop to panicking financial markets.

Finance ministers prefer G8 meetings, they say privately, because they offer a smaller forum to discuss events privately and freely without having to make speeches to hundreds of people. Instead of dying, the G8 is alive, well and already has a summit in the diary for Chicago next May.

Not only is the G20 unwieldy, but it also has a legitimacy problem. Although much more representative of the global economy than the G8, the wider group does not include all the world's 20 largest economies. Spain, for example, tends to rank somewhere near 13th in the world but merely has observer status. South Africa, the only African nation in the G20 as of right, has an economy that tends to rank close to 25th.

Hangers-on also abound. At G20 summits, these generally include the United Nations, the chair of the African Union, the president of the European Union, the head of Asean, the IMF, the World Bank, the International Labour Organisation, the Organisation for Economic Co-operation and Development, the World Trade Organisation and the Financial Stability Board.

With such a cast list, decisions are difficult to agree at a G20 summit unless comprehensively trailed in advance.

The Cannes summit therefore has more of a challenge than usual in defusing a crisis that threatens the global economy.

Whether it can move from platitudes to policy on the eurozone and on global imbalances will be the test of its relevance as a body, even if it has already shown itself to be short of the world's premier global economic forum.

Double act: Angela Merkel and Nicolas Sarkozy arrive at last week's European Council summit to solve the eurozone debt crisis Bloomberg

Rescue raises doubts over details and deeper issues

Eurozone options

The single currency is not yet out of the woods, writes **Ralph Atkins**

What will happen to the eurozone? The run-up to the G20 summit has seen frantic summit activity in Europe to restore investor confidence in the continent's almost 13-year old monetary union.

With just days to spare before the global gathering in Cannes, eurozone leaders have agreed a three-pronged strategy to put Greece's public finances back on a sustainable basis, to strengthen European banks' balance sheets, and to beef up the European Financial Stability Facility (EFSF) as a multifunctional rescue vehicle that can "ring fence" crisis-spots.

But considerable doubt remains over whether such steps will be sufficient, even before Monday's announcement that Greece will hold a referendum on the bail-out. It is not just that many of the plan's details still have to be worked out, let alone implemented. It is also unclear whether fundamental flaws in the eurozone's construction have been corrected.

"There is hope that we have turned an important corner," says Huw Pill, European economist at Goldman Sachs. "But there are still deeper issues that need to be addressed."

Most crucial are the governance of the eurozone – which has a single currency but 17 separate fiscal authorities – and divergences in economic competitiveness which lie at the heart of its problems.

Beyond the eurozone, especially among international investors, there is scepticism over whether some kind of break-up can be avoided in the long run.

European politics have certainly given pause for thought. Berlin and Paris have frequently clashed over strategy. The government of Angela Merkel envisages a "rules-based" union in which fiscal miscreants are punished and the central bank sticks to controlling inflation.

The German chancellor has taken an incremental approach to crisis resolution, insisting that problems built up over years cannot be resolved quickly.

By contrast, Nicolas Sarkozy, French president, has favoured bolder solutions, arguing, for instance, that the European Central Bank should act more aggressively as a backstop for governments.

Yet the forces that have driven Europe's economic integration since the second world war remain in place, and provide an explanation of why – despite everything – continental Europe's leaders see the only option as pressing ahead with the "project".

Ms Merkel recently told Germany's Bundestag: "The euro is a guarantor of a united Europe, or put it another way: if the euro fails, Europe fails."

Jean-Claude Trichet used more mercantilist reasoning in a Financial Times interview before he stepped down as ECB president on October 31.

"There are more reasons today for the Europeans to unite in economic, financial and monetary fields than there were at the beginning of the 1950s," he said. "I really think that the structural transformation of the world, the formidable economic success of the emerging countries, of China, of India, of all emerging Asia, of Latin America, calls for the Europeans to unite very significantly.

"One of the main lessons of the crisis is precisely that Europe needs more unity."

The eurozone remains a long way from a fiscal union – but steps towards a greater pooling of sovereignty have already been made that would have been unimaginable even a few years ago.

With the launch of the EFSF, which has powers to raise funds in capital markets, the European Union has a prototype common "euro bond".

Surveillance of fiscal and competitiveness policies has also been strengthened. At their Brussels summit on October 26, eurozone leaders pledged to "strengthen the economic union to make it commensurate with monetary union".

Under discussion are measures that would see EU authorities, in effect, taking control of the domestic policies of eurozone member states that failed to follow its rules. Changes to treaties are on the agenda.

The big test of whether it can all work will be what happens to Greece. The country's mountainous public sector debt – masked by unreliable statistics – and severe loss of economic competitiveness triggered the eruption of the eurozone debt crisis in early 2010.

Since then, Greece's problems have escalated, as the Athens government failed to implement ambitious structural reform plans demanded by international creditors. The country has been plunged into a deep recession and images of violent protests are beamed daily around the world.

At the October 26 summit, Greece was given another chance. An agreement on a larger "private sector involvement" is aimed at bringing the country's debt down to a manageable 120 per cent of gross domestic product – compared with official forecasts that it could rise to nearly 200 per cent.

Until signs of a sustainable Greek economic turnround emerge, however, it will be unclear whether the necessary adjustment in wages and other costs will be possible because monetary union rules out currency devaluations.

As a result, the possibility remains of Greece leaving the eurozone.

A return to the drachma might bring short-term gains in terms of competitiveness – but the benefits are far from clear, given the enormous disruption a withdrawal from the eurozone would cause.

Beyond Greek borders, however, talk of allowing countries to exit the eurozone has started – in the context of a strengthened political union.

Mark Rutte, the Dutch prime minister, for instance, has argued for a European commissioner for budget discipline with powers to force a country to put its finances in order.

"Countries that do not want to submit to this regime can choose to leave the eurozone," he wrote in the FT last month.

The risk of allowing one country to exit at some point in the future would be serious "contagion effects", as financial markets bet on the next member to leave.

More immediately, the firewalls put in place by eurozone leaders, including the enhanced EFSF, may prove insufficient to restore investor confidence beyond the short term.

So far, the ECB, which has theoretically unlimited firepower, has explicitly refused to become the lender of last resort for governments.

For all Germany's commitment to European integration, its voters remain deeply wary of the potential cost of its support for countries such as Greece.

A eurozone break-up would be a bitter blow for a generation of European leaders – but not yet a scenario that can be ruled out.

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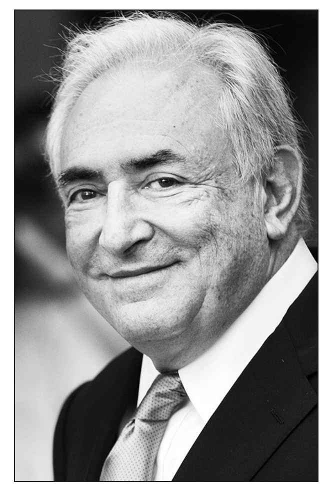
France made reform of the international monetary system a centrepiece of its G20 presidency, recognising how important this could be for addressing global imbalances, writes **Claire Jones** (pictured). But reform has slipped down the agenda, which has much to do with the eurozone crisis. One observer says there has been a lack of intellectual leadership. For the full story, and a look at what is next for international monetary reform with Mexico taking on the presidency next year, go to **www.ft.com/g20-2011**

Mutual suspicion thwarts grand plan

Global rebalancing

A move to boost co-operation has hit difficulties, says **Alan Beattie**



Strauss-Kahn: added to several initiatives

Having been elevated from finance minister to head of government level in November 2008 in the middle of the deepest financial crisis since the Great Depression, the G20 spent most of its first year on crisis fighting rather than grand designs for the global economy.

The April 2009 summit in London was notable for a call for monetary and fiscal policy to stimulate the global economy and for offering a string of promises of varying reliability about how the G20 would pump liquidity into the international system and prevent a collapse in world trade.

As soon as the crisis began to recede in 2009, enthusiasts for the G20 process, flushed with what they considered to be success from its early months, wondered if it could be turned to addressing chronic underlying problems rather than simply be an emergency service called to acute cases of economic distress.

Out of this curiosity came what were touted as grand schemes for rebalancing the world economy.

Global current account imbalances – the US deficit being matched by surpluses in China, Japan and a few other countries – had been one of the main preoccupations of policymakers before the global financial crisis in 2008 drew their attention to more pressing concerns.

The US, in particular, had tried a variety of ways to persuade China to allow more flexibility in the renminbi, including direct bilateral pressure on Beijing, pressing the International Monetary Fund to sharpen its analysis of exchange rates, and convening a group of countries within the IMF under the rubric of multilateral surveillance.

None of these had conspicuous success, with the US's enthusiasm for letting the renminbi rise not being matched to quite the same extent by other large economies, including the eurozone.

In any case, China resisted pressure applied through any and all of these channels – to the extent where Beijing in effect blocked the IMF from producing its annual "Article 4" health-check on the Chinese economy.

Undaunted, the US saw in the G20 the potential for another try, and thus at the Pittsburgh G20 summit in the autumn of 2009 was born the "mutual assessment process" (MAP) – commissioning the IMF to come up with suggestions for rebalancing policies that each G20 government could follow.

If Washington believed this new approach was likely to sidestep the political obstacles to the previous ones, it was mistaken.

In theory, the gains from economic co-operation could be huge. The idea was that China could float its currency and rebalance its economy, shifting demand from exports to domestic consumption. In return, the US would reduce its fiscal and external deficits.

In practice, the plan has run into distinct difficulties – not just in the mutual suspicion that each side will renege on its part, but on a more fundamental disagreement about what the underlying problems in the global economy actually are.

> Beijing managed to soften proposed guidelines on real exchange rates and current account surpluses

The Cannes summit was intended to be the end point of a two-year process in which the IMF would come up with suggestions for economic indicators that each country could adopt as its contribution to reducing global imbalances.

But perhaps the key moment – and the one that has caused widespread scepticism about the ability of the MAP to succeed where similar initiatives had failed – came in the run-up to the November summit in Seoul last year, when the US pushed hard for numerical guidelines including targets of 4 per cent for current account surpluses.

In open disagreement, China fought back hard against the idea that these would be binding numerical proposals. Beijing received support from some slightly unexpected quarters such as Germany, which feared that it would be asked to reduce its current account surplus, most likely by loosening fiscal policy.

In the end, the G20 decided in principle that guidelines would be produced, but the US failed to get agreement about hard numerical indicators. That discord rapidly diminished the possibility that the MAP would succeed where previous plans had failed.

At the first ministerial meeting of the G20 under France's leadership, in Paris in February, China led another successful rearguard action, this time blocking the adoption of targets on foreign exchange reserves.

Beijing also managed to combine and soften proposed guidelines on real exchange rates and current account surpluses and deficits into a wider category of external balances.

To add to the plethora of initiatives, Dominique Strauss-Kahn, then the head of the IMF, also launched a series of "spillover reports", designed to indicate how the large economies interacted with each other and affected the global economy.

The first round of such reports were published this summer and signally failed to set the policymaking world on fire.

The reports made fairly minimal assessments of the impact of national policies on the global economy, including a prediction that a revaluation of the renminbi would not make much difference to US current account deficits.

With the G20's attention having been drawn once more to the immediate future by the eurozone crisis, there seems little chance that the adoption of guidelines with qualitative or quantitative indicators at the Cannes summit is going to make any practical difference in the short run to the way that the global economy is run.

If so, they are likely to join a growing pile of initiatives that have tried and failed to induce co-operation over rebalancing the world economy.

Contributors

Chris Giles
Economics Editor

Ralph Atkins
Frankfurt Bureau Chief

Alan Beattie
International Economy Editor

Paul Betts
European Business Correspondent

Hugh Carnegy
Paris Bureau Chief

Claire Jones
Money Supply and Economics Team Writer

Brooke Masters
Chief Regulation Correspondent

Andrew Baxter
Commissioning Editor

Steven Bird
Designer

Andy Mears
Picture Editor

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Banks and regulators at odds

Financial services

Brooke Masters finds the debate over Basel III and other new rules is heating up

In the months leading up to the Group of 20 nations meeting in Cannes, global banking executives have mounted a furious attack on the Basel III reforms that will force their institutions to hold more capital and liquid assets.

They single out the capital surcharge for "global systemically important financial institutions" (GSifis), which is on the agenda for formal endorsement by the G20. It will, they say, hobble already fragile economic growth and force the 28 to 30 largest and most interconnected banks to shrink their lending to the world economy.

"There is an acute danger that the pursuit of financial stability imposes too great a cost on economic growth and job creation at a fragile time for the world economy," Peter Sands, chief executive of Standard Chartered said in September as he unveiled an industry study that emphasised the potential cost of the regulations.

Regulators, meanwhile, want the G20 politicians to endorse not only their capital regime but also their plans to force banks to write their own "living wills" that would make it easier to break up or shut down failing institutions.

Without a global framework for handling cross-border bank failures, the world economy is still vulnerable to a repeat of the disastrous 2008 collapse of Lehman Brothers.

Lord Turner, chairman of the UK Financial Services Authority, said recently: "We are committed, in the UK and globally, to putting a stop to 'too big to fail' status, with resolution tools which can deal smoothly with the failure of a bank however large."

So far, signs point to a G20 endorsement of both the "GSifi" surcharge and the resolution framework, but it is not at all clear what that rhetoric will mean in practice.

Recent history suggests that national interests – both in protecting local champions and in wooing overseas business – tend to reassert themselves when the G20 leaders go home.

Agreements reached at prior summits on raising bank capital requirements, tying banker pay to risk and taming over-the-counter derivatives, have all become snarled in local issues during the implementation phase.

Steve Culp, global managing director of Accenture's risk management practice, says: "In many ways, the 2009 London G20 marked the high-water point for collaboration across the global political, industry and regulatory agendas.

"Since that event, local and national agendas have taken precedence over a common and consistent set of global rules."

While many of the efforts are aimed at furthering the agreements, the actual details often conflict, causing confusion and raising potential costs for the industry.

The European Union is drafting laws on bank capital, derivatives trading, credit rating agencies and a host of other measures, while the US is drafting more than 100 rules, many of them on similar subjects, to implement its Dodd-Frank reform law.

David Holcombe, specialist in trading at Rule Financial business and technology consultancy, says: "The barrage of reforms and regulations is being applied differently by the various regional and national regulators.

"This extraterritoriality is resulting in a disjointed approach to improving transparency and reducing risk across financial services, globally.

He adds: "This encourages regulatory arbitrage. The jurisdiction that enforces the first or most negative set of rules will drive participants elsewhere, which in the long term is damaging to any market that needs multiple types of investors with different investment horizons."

> The eurozone crisis and faltering economies have damped enthusiasm for tough reform

Research by Accenture shows that more than 150 pieces of global or domestic financial services regulations are being written right now on top of the US Dodd-Frank process.

In some ways, this was only to be expected, given the different national priorities. The US, UK and Switzerland are especially focused on preventing a repeat of the crisis, but other countries have different goals.

Tim Kirk, head of financial services at BDO, a consultancy, says: "While global consistency is proving more challenging than governments and regulators may have expected, industry practitioners are much less surprised . . .

"Some governments place different priority on attracting business and being seen as a competitive place to do business as opposed to ever tighter regulatory standards and the higher costs these bring."

The continuing crisis in the eurozone and faltering economies worldwide have also damped enthusiasm for tough reform.

Giles Williams, co-head of KPMG's Regulatory Centre of Excellence in Europe, says: "The recognition that bank lending is crucial to stimulating the global economy is putting significant pressure on the financial stability policy objectives. The politicians face a real conundrum that too much safety could lead to further economic contraction."

Bankers, meanwhile, are rethinking which business lines will still be profitable under the new regimes and are warning that some activities – including lending – could become much more expensive.

Patricia Jackson of Ernst & Young, says: "There is no doubt that the combination of higher capital, leverage restrictions and liquidity buffers is putting pressure on the industry."

These pressures are likely to make it hard for the G20 to decide what to do next.

With global regulatory groups such as the Basel Committee on Banking Supervision (author of the Basel III reforms) and the Financial Stability Board focused on implementation and ensuring level playing fields and the banking industry struggling to rethink its business models, where should politicians put their energy?

Peter Sands of Standard Chartered: warned of risks from chasing financial stability Getty

Barbara Ridpath, chief executive of the International Centre for Financial Regulation, a think tank, has a partial answer.

"It's critical that G20 leaders recognise the role of securities markets in raising finance for companies to grow, and providing long-term investment returns for investors and savers . . . They have got to keep their 'eye on the prize' of how good regulation can support growth," she says.

Former regulator Clifford Smout, now with Deloitte, has another prediction. He says: "On the whole, discussion has been on the prudential side . . . It hasn't really moved on to consider consumer protection.

"But if you look at the US, UK and EU, that is clearly part of the issue. That may be a theme that comes to the fore over the long term." he says.

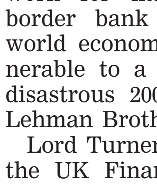
Global leaders under pressure

Continued from Page 1

contagion spreading from Greece to other eurozone economies and medium-term reforms to the governance of the eurozone to prevent a recurrence of fiscal and trade imbalances within the zone.

The enhanced European Financial Stability Facility will have two elements in a package with more than €1,000bn of firepower: limited insurance for sovereign debt of peripheral countries and a new leveraged fund to buy debt outright.

Underpinning the details is the idea that medium-term German and French finance for peripheral eurozone countries will be balanced by German and French control of economic policy across the eurozone, in what Angela Merkel, German Chancellor, euphemistically calls a "stability union".



The IMF has a substantial arsenal of resources, says Tim Geithner

Once these elements of a package are agreed, the French hosts hope that non-eurozone countries will boost the credibility of the plan at the G20, either through additional bilateral or IMF support. The aim would be to provide overwhelming firepower behind the eurozone and stop traders betting on a eurozone break-up.

G20 finance ministers made clear in Paris that such a deal was a possibility, though it is far from a certainty in Cannes.

Speaking in a similar vein to many non-eurozone finance ministers, Tim Geithner, US treasury secretary, said: "The IMF has a substantial arsenal of financial resources, and we would support further use of those resources to supplement a comprehensive, well-designed European strategy alongside a more substantial commitment of European resources."

In contrast to hastily devised plans to defuse the eurozone crisis, the G20's progress in reducing global imbalances inches forward at glacial speed. The added difficulty, as Mr Levitte makes clear, is that unlike in 2009, there is no unifying theme for action needed to foster a stronger and more balanced global economy.

He says: "The message from Cannes will have to be more diverse; some nations need to focus on measures to boost their economy, others on consolidating their public finances, and still others on rebalancing their economic models to promote domestic consumption."

On past experience, gaining agreement on general themes and objectives will be easier than specific changes in domestic policies of any G20 member.

In addition, France is still keen to be seen to have made some progress on Mr Sarkozy's original ambitions for the 2011 G20 agenda on reforming the international monetary system.

It is expecting specific agreements on rules governing the management of international capital flows – allowing countries in limited circumstances to impose capital controls.

France also hopes to increase the range of IMF credit lines available to help well managed countries that are exposed in a crisis, co-ordinating these flows with those of Europe and Asia.

And it hopes to continue discussion on exchange rates, particularly that of the renminbi, although it acknowledges there will be no breakthrough in Cannes.

But the problem for world economic governance is that it still faces a deep collective action problem.

Policy changes that would foster the common good are seen as counter to individual countries' domestic interests. This obstacle has forced France to scale back its longer-term ambitions for Cannes.

The potential for the summit to make progress in fighting the immediate eurozone crisis is therefore something of a boon for Mr Sarkozy as he prepares for Cannes. Without the crisis, the potential achievements of the summit were looking extremely limited.

G20 Summit

Riviera resort shows off its Cannes-do attitude

Location profile

The seaside city has come a long way since British aristocrats put a sleepy fishing village on the high society map, writes **Paul Betts**

Now and then: the seafront at Cannes and (inset) film stars parade in the street in 1947

Alamy, AFP/Getty

Cannes loves putting on a show. The French Riviera resort does exactly that every year, with what has become, since 1946, the world's most prestigious film festival. So hosting the latest G20 summit is the sort of big international event the city can take in its stride.

Of course some of its 80,000 or so local residents will inevitably complain of the disruption the G20 will provoke, with all its security measures and motorcades of heads of states and their entourages.

After all, this is a time of year when the city, with its promenade (the "Croisette"), its grand hotels and casino, its marina stuffed with fancy yachts, its markets and smart shops, becomes rather pleasantly quiet yet still sunny after the hustle and bustle of the summer season.

Henry Brougham: discovered Cannes in the 1860s Getty

But then Cannes is no longer the exclusive winter resort of the old British aristocracy that flocked to the Riviera after Henry Brougham, the lord chancellor of Great Britain, discovered this sleepy Mediterranean fishing village in the 1860s and put it firmly on the high society map.

Later, American literati, including the writer Scott Fitzgerald, made Cannes and its immediate surroundings even more fashionable and famous.

These days, the city relies on its film festival, boat show and other big events and conventions to keep its economy, which relies mainly on tourism, turning all year. The tourist season has now shifted from winter to summer, but Cannes' good transport facilities – the busy international airport at Nice is close by and high speed TGV trains serve its station – have made it an attractive convention centre competing with its much bigger neighbour Nice and, a little further down the coast, Monaco.

The seaside city also serves a high-technology cluster in the neighbourhood, even though the Sophia Antipolis technopolis has never really lived up to its early ambitions of becoming a French Silicon Valley.

But Cannes can boast a role in the European space industry with the headquarters of the Franco-Italian Thales Alenia space venture a few miles away at Mandelieu. It is one of Europe's leading satellite manufacturers.

Cannes' balmy climate – tender indeed are its nights, as Scott Fitzgerald noted – and privileged position have also made it increasingly popular with French and European retirees, helping to prop up local property prices even during the current economic downturn.

This, together with the growing appetite for holiday homes has inevitably urbanised the coast transforming it, sadly, for those who knew it before the steady property development and expansion of recent years, into one long suburban strip from Nice to Cannes and beyond.

Even the hills in the hinterlands are scattered with housing developments and holiday residences.

Lord Brougham, who built the first of the grand old villas of Cannes (the Villa Eleonor-Louise, named after his daughter), would certainly be raising an eyebrow or two if he saw what modern development has done to his once bucolic Riviera haven.

Mercifully, the Carlton hotel is still there, with its twin domes representing the breasts of the belle époque courtesan Caroline "la belle" Otero, and so are the other Croisette grand watering holes – the Martinez, the Majestic and the Grand Hotel at the tip of the Cap d'Antibes.

These hotels no doubt will be teeming with heads of state, their mandarins, central bankers, ministers, security guards and journalists during the summit.

It is undoubtedly occasions like this that help maintain the profile of Cannes and the Riviera at large on the international stage. It also seems appropriate that President Nicolas Sarkozy chose Cannes to host the present G20 meeting.

It is bound to provide as much drama and suspense as the Cannes Film Festival itself but without, some may regret, quite the same colourful and frivolous cocktail of glamour, gawpers, baubles, bangles and beads. Yet you never know.

Hope is to cut while still fostering growth

French economy

Concrete steps are finally being taken to reduce public spending, reports **Hugh Carnegy**

As the eurozone sovereign debt crisis has escalated over the past 18 months, France has had to deal with an uncomfortable truth: its room for manoeuvre in the tortured series of negotiations over successive rescue plans was limited by the relative weakness of its own fiscal and economic circumstances.

The country is one of only six members of the eurozone with a triple A rating on its sovereign debt (along with Germany, the Netherlands, Austria, Finland and Luxembourg). It remains a major force in the European economy, with an impressive line-up of multinational companies.

President Nicolas Sarkozy's centre-right government, in power since 2007, has been committed to a programme of structural reform and is doggedly chipping away at the budget deficit in an attempt to reduce the size of the public sector and give a long-term stimulus to the economy.

But France continues to be constrained by heavy fiscal pressures and feeble growth. That, along with worries about the exposure of its banks to risky eurozone sovereign debt, has cramped its scope for supporting eurozone bail-out plans and raised questions over the sustainability of its triple A rating.

Behind this lies a deeper worry over weakening competitiveness, especially against Germany. Since the mid-2000s, France has slipped behind its neighbour in terms of its performance on growth, export market share and employment.

In the short term, the government's top priority is to bring down the budget deficit, set to hit 5.7 per cent of gross domestic product this year, to a target of 3 per cent in 2013 – and to converge on a balanced budget in the years beyond.

This would enable it to control a sharp rise in the public debt, which, under the current programme, will peak at more than 87 per cent of GDP next year.

It is doing so through a series of austerity measures that have encompassed everything from increased taxes on the rich, new taxes on sweetened soft drinks and the axing of 10,000 official cars.

It is trying to do this without damaging what little growth there is in the economy, preserving tax breaks such as reduced VAT on restaurants and preserving subsidies for research and development.

"In an environment of relatively low economic growth combined with high public debt, the challenge is for the government to balance fiscal consolidation and growth-enhancing economic policy measures," said Moody's, the US rating agency, in its latest report on France.

The agency concluded by warning that it might cut its outlook on France's triple A from stable to negative if the eurozone crisis were to cause the situation to deteriorate over the next three months.

[This government] will put an end to the continual increase in spending by the state'

Valérie Pécresse, Budget minister

Circumstances are certainly not getting any easier: the government has acknowledged its forecast of 1.75 per cent growth next year is too optimistic and it is set to reduce the estimate closer to consensus forecasts of about 1 per cent.

That will require further austerity measures to keep the budget deficit reduction on target.

Despite the fact that Mr Sarkozy faces a presidential election next April, he is determined to make a virtue of reforming the public finances as part of a wider plan to increase growth potential.

He does not like his ministers to use the words "rigour" or "austerity", but they are open about the drive to reverse a period of more than 30 years in which public finances have been in deficit.

This has culminated in debt servicing becoming the single largest expenditure in the budget, reaching €48.8bn next year. However, another statistic from the budget projections indicates a potentially important turning point, as the government's efforts to bear down on public expenditure take hold.

This year, the size of public spending as a proportion of GDP – one of the highest in Europe – will fall to 56.3 per cent from 56.6 per cent in 2010. It will fall to below 56 per cent next year and continue to decline if current policies are held in place.

That is much higher than, for example, that of Germany, the usual comparator for the competitiveness of the French economy.

Nevertheless, Valérie Pécresse, the budget minister, insists it is a "historic change". She declared in the National Assembly: "This has not happened since 1945 and it is [this government] that will put an end to the continual increase in spending by the state."

Mr Sarkozy has been criticised for not pushing harder on structural reforms, but the reversal of the hitherto relentless increase in the state's share of the economy is helped by important measures taken during his tenure.

The minimum pension age has been raised from 60 to 62 and the age for receiving a full pension is being raised from 65 to 67. A programme of not replacing one in every two retiring public servants has led to a reduction in public sector employment of 150,000 over five years.

Concerns remain – widely expressed by the private sector – over things that undermine competitiveness. These include very high costs imposed on employment where, again, France has fallen out of step with Germany.

Another factor is a perceived shortage of private capital for business, with a weak infrastructure of pension and other investment funds willing to finance growing companies.

But the private sector does take some comfort from what it sees as a growing consensus on the need for a serious reduction in public indebtedness and a recognition of the need to stimulate more private sector employment.

"The idea of implementing serious reforms to obtain real fiscal consolidation is accepted, even in the [recent] debate among the socialist presidential candidates. We are making progress," says Laurence Parisot, head of Medef, the employers' federation.